

HOW TO JUMP START YOUR ASC 842 LEASE ACCOUNTING PROJECT

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Today's Panelists



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Polling Question #1

How familiar are you with the ASC 842 leases standard?

- a) Extremely familiar, we're already implementing
- b) Very familiar, I know what we have to do, but I'm unclear on a few issues
- c) I have heard of it, but I really don't know where to start
- d) Completely in the dark--What is 842?

OVERVIEW OF THE STANDARD

Overview of key changes - Lessees

Recognition of all leases with an original term of greater than 12 months on balance sheet

- The critical accounting determination will be whether a contract contains a lease. The lease classification distinction will affect how lessees measure and present lease expense and cash flows – not whether the lease is on or off-balance sheet as it does under current U.S. GAAP.
- Classification as operating or finance lease is based on criteria similar to, but not identical to, those in current U.S. GAAP.
- A lessee will recognize a right-of-use (ROU) asset and a lease liability for all leases, including operating leases, with a term greater than 12 months.
 - Entities will be required to perform ongoing evaluation of ROU assets for impairment
- The new standard has a narrow definition of initial direct costs. Some costs incurred in negotiating and arranging a lease that are capitalized under current U.S. GAAP will now be expensed when incurred.

Overview of key changes - Lessees

Separation of lease and non-lease components

- If there are lease and non-lease components (e.g., services), an entity applies the new standard to the lease components and other U.S. GAAP to the non-lease components, unless a lessee elects (by class of underlying asset) to account for non-lease components as part of the lease component to which they relate.
- The consideration in the contract is allocated to the lease and non-lease components on a relative standalone price basis, maximizing the use of observable information.
- Executory costs that do not represent payments for a good or service (e.g., payments to cover the lessor's costs of ownership, such as property taxes or insurance) are not considered non-lease components and, therefore, will be allocated to the lease and non-lease components in the same manner as all other payments in the contract (i.e., will not be excluded from lease accounting as they are under current U.S. GAAP).

Overview of key changes - Lessees

Expanded disclosures

- The disclosure objective of ASC 842 is to provide the financial statement users sufficient information to assess the amount, timing and uncertainty of cash flows arising from leases.
- Qualitative disclosures, such as information about the nature of leases (terms and conditions of variable lease payments, extension and termination options, purchase options, residual value guarantees, etc.).
- Quantitative disclosures, such as operating lease cost, amortization of finance lease ROU assets and interest on finance lease liabilities, variable lease cost, weighted-average remaining lease term, weighted-average discount rate, and a maturity analysis of lease liabilities.

Overview of key changes - Lessees

Other transactions

- ASC 842 eliminates sale-leaseback accounting as an off-balance sheet financing proposition as the seller-lessees will recognize a ROU asset and a lease liability for the leaseback.
- The new standard eliminates the current build-to-suit lease accounting guidance and, instead, stipulates that a lessee is the accounting owner of an asset under construction when it controls that asset before the lease commencement date rather than whether the lessee takes on risks during the construction period.
 - Under ASC 842, if the lessee controls the asset during construction, the asset is capitalized as construction-in-progress and is subject to the sale and leaseback guidance at the end of construction.
- The transition provisions of the new standard will permit many entities to derecognize build-to-suit assets and liabilities that have remained on the balance sheet after the end of the construction period under current U.S. GAAP.

Overview of key changes - Lessees

Financial metrics, key performance indicators and capital structure impact

- Return on assets, debt-to-equity ratios and liquidity
- Debt covenants, interest coverage ratios and EBITDA/EBIT levels
- Recognition of foreign currency remeasurement gains and losses related to lease liabilities that are denominated in a currency that is different from a Company's functional currency

Tax

- Recognition of lease-related assets and liabilities that are not on the balance sheet today would impact certain aspects of accounting for income taxes, such as:
 - Recognition and measurement of deferred tax assets and liabilities
 - Assessment of recoverability of deferred tax assets and liabilities
- Uncertainty around whether the ROU asset would be:
 - State and local tax: Included in the property factor for apportionment of income
 - Sales and use tax: Subject to sales tax
 - Property tax: Included in property tax base

Overview of key changes - Lessors

Same basic lessor accounting model is retained with some nuances

Lease classification

- A lessor will classify leases as (1) sales-type, (2) direct financing or (3) operating using criteria similar to current U.S. GAAP. Leveraged lease classification, however, will be eliminated prospectively. Unlike current U.S. GAAP, leases with predominantly variable payments may be classified as sales-type or direct financing leases.

Collectibility uncertainties

- Unlike current U.S. GAAP, a lease with collectibility uncertainties can be classified as a sales-type lease. If collectibility of the lease payments, plus any amount necessary to satisfy a lessee residual value guarantee, is not probable for a sales-type lease, lease payments received are recognized as a deposit liability (i.e., not recognized as lease income) and the underlying asset is not derecognized generally until collectibility of the remaining amounts becomes probable.
- Collectibility uncertainties for a lease that otherwise would be a direct financing lease result in operating lease classification. Lease income recognized for operating leases when collectibility is not probable is limited to cash received from the lessee until collectibility of the remaining lease payments becomes probable.

Overview of key changes - Lessors

Expanded disclosures

Qualitative

- Information about leases
- Nature of variable payment arrangements
- Termination, renewal, and purchase options
- Information about how the lessor manages residual asset risk, including information about residual value guarantees and other means of limiting that risk
- Significant accounting judgments and estimates

Quantitative

- Maturity analysis of lease receivables for sales-type/direct financing leases and of lease payments for operating leases
- Table of lease income
- Selling profit (or loss) recognized at lease commencement and interest income for sales-type/direct financing leases
- Operating lease income
- Variable lease income

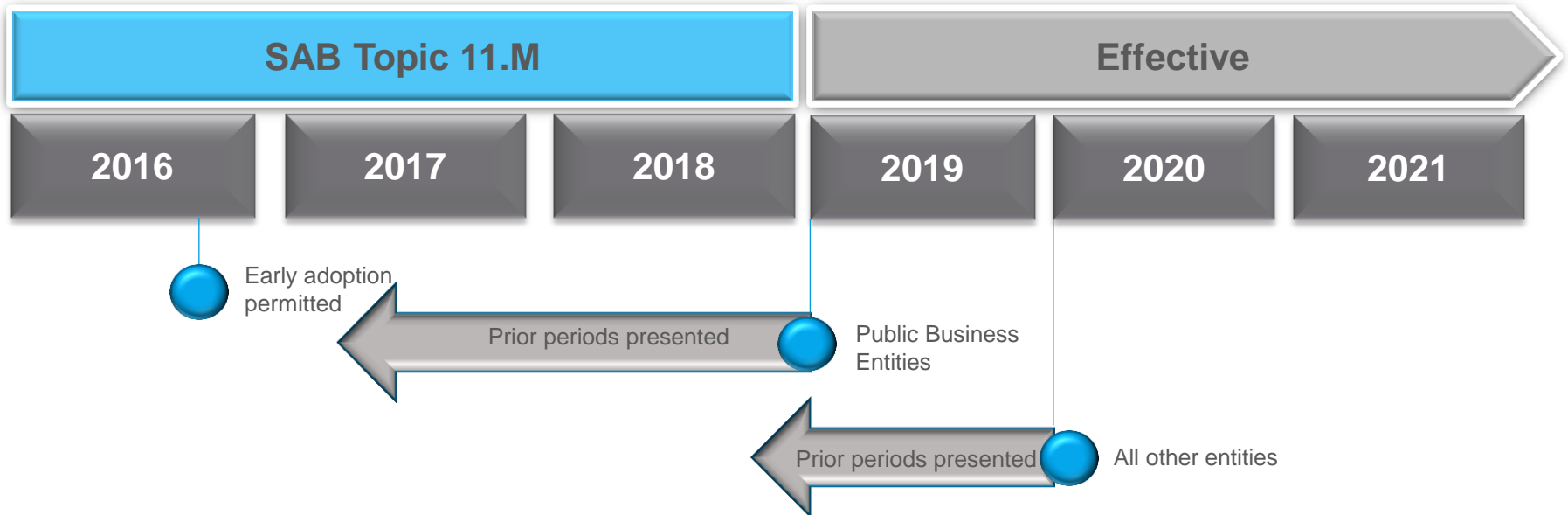
Polling Question #2

Approximately how many leases do you have?

- a) Under 100
- b) 100-500
- c) Over 500
- d) Unsure

TRANSITION TO THE NEW STANDARD

Effective date and transition



- The transition provisions are applied using a modified retrospective approach.
- The FASB issued a **proposed** ASU in 1/18 to allow another transition method in addition to the existing requirements to transition to the new lease standard by recognizing a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption consistent with the request by preparers. This additional transition method would change *when* an entity would be required to initially apply the transition requirements of the new lease standard; it would not change *the date of adoption or how* those requirements apply.
- Private companies are required to adopt on 1/1/20

Practical expedients

- Lessees and lessors are permitted to make an election to apply the package of practical expedients and/or the hindsight practical expedient

Package of expedients (1) (2)

- Do not re-assess:
 - Whether contracts are or contain leases
 - Lease classification
 - Whether initial direct costs qualify for capitalization

Hindsight expedient

- Use hindsight when determining the lease term and assessing impairment of ROU assets (lessees only)

(1) Practical expedient may be elected separately or in conjunction with the hindsight expedient.

(2) Must elect as a package and must be consistently applied to all leases.

Note: Land easements--optional transition practical expedient that will permit an entity to continue applying its current policy for accounting for land easements that existed as of, or expired before, the effective date of ASU 842. If elected, will apply it to all of its existing or expired land easements that were not previously assessed under today's lease guidance. Entities that elect the practical expedient will still need to evaluate whether land easements entered into or modified on or after the effective date meet the definition of a lease under ASC 842.

Accounting policy elections--lessees

- Certain accounting policy elections related to leases must be made and documented:
 - Short-term leases (term of less than 12 months) are excluded from recognition and recognized over the lease term
 - Requires careful evaluation of renewal options
 - By class of underlying asset, choose not to separate nonlease components from lease components
 - Discount rate (non-Public Business Entities)—can choose to use a risk-free discount rate for the lease, determined using a period comparable with that of the lease term, instead of incremental borrowing rate related to leased asset
 - Portfolio approach--may apply guidance to a portfolio of leases with similar characteristics (size and composition) if reasonably expect that the application of the leases model to the portfolio will not differ materially from the application to the individual leases in that portfolio.

HIGH LEVEL COMPARISON OF ASC 842 AND IFRS 16

Comparison of ASC 842 and IFRS 16—Key considerations

IFRS 16	ASC 842	Key Considerations
Effective date The new standard is effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted if the new revenue standard is also adopted.	ASC 842 is effective for annual periods beginning after December 15, 2018 (public business and certain other entities) and after December 15, 2019 for other entities. Early adoption is permitted.	Nonpublic dual reporters may decide to adopt both ASC 842 and IFRS 16 on the same date.
Transition approach and comparatives Full retrospective approach, or modified retrospective approach with practical expedients available. The modified retrospective approach is based on leases at the date of initial application and comparative information is not restated. Instead, the effect of adopting the new standard is recognized in opening retained earnings (or other equity component as appropriate) at the date of initial application.	Modified retrospective transition is required for all leases existing at, or entered into on or after, the beginning of the earliest comparative period presented in the financial statements – i.e. comparative information is restated. Practical expedients are available on transition, which are less extensive than those under IFRS.	Dual reporters may need to start implementing the leases standards earlier than companies that only report under IFRS to be able to present comparative information in their US GAAP reporting. They should also consider whether applying the full retrospective approach under IFRS 16 will result in greater comparability in the comparative periods presented.
Leases recognized on the balance sheet Lessees may elect to apply the recognition exemption for leases of 'low-value' assets – i.e. underlying assets with a value ≤ \$5,000 when new, even if they are material in aggregate.	There is no exemption for leases of low-value assets.	Dual reporters will have to decide whether to use the low-value exemption or recognize leases of low-value assets to maintain consistency between US GAAP and IFRS reporting. When applying the exemption, entities will have to identify leases of low-value assets in the entire lease population to quantify the adjustment between US GAAP and IFRS.
Lease classification Lessees apply a single on-balance sheet lease accounting model.	There is a dual classification on-balance sheet lease accounting model for lessees: finance leases and operating leases. Lease classification affects measurement of the right-of-use asset, lease expense and income statement presentation.	Dual reporters will have to separately track leases that have a different classification between US GAAP and IFRS because their accounting will be different.
Remeasurement assessment for leases tied to an index or rate Lessees remeasure the lease liability for changes in variable lease payments based on an index or rate on the date when there is a change in the contractually required cash flows.	Adjustments to an index or rate do not constitute a reassessment event.	Dual reporters will have to separately track the remeasurement assessment for leases that are tied to an index or rate.
Sale-leaseback transactions If the seller-lessee has a substantive option to repurchase the underlying asset, the transfer is not a sale. The seller-lessee measures the right-of-use asset at the retained portion of the previous carrying amount of the underlying asset (i.e. at cost). Only the amount of any gain or loss related to the rights transferred to the buyer-lessor is recognized.	If the seller-lessee has a substantive option to repurchase an underlying asset that is not real estate, the transfer may be a sale under certain circumstances. If the leaseback would be classified as a finance lease by a seller-lessee (or as a sales-type lease by the buyer-lessor), then sale recognition is automatically precluded. The seller-lessee measures the right-of-use asset at the present value of the lease payments in the same way as any other lease. A gain or loss is recognized for the difference between the sale proceeds and the carrying amount of the underlying asset.	Dual reporters will have to separately track the accounting for sale-leaseback transactions.
Subleases Unless the sublessor for the head lease applies the recognition and measurement exemption applicable to short-term leases, a sublessor classifies a sublease by reference to the right-of-use asset arising from the head lease.	A sublessor classifies a sublease by reference to the underlying asset.	We expect that most subleases under ASC 842 will be classified as operating leases, while most subleases under IFRS 16 will be classified as finance leases by the sublessor.

Polling Question #3

Approximately how long will it take to fully implement the new standard at your organization?

- a) 1 month
- b) 3-6 months
- c) 12 months
- d) 5 years

PROJECT APPROACH

ASC 842 Approach

Assessment and Strategy



Project Initiation and Planning

- Plan impact assessment
- Understanding of business strategy, organizational overview, business systems



Business Requirements

- Current lease portfolio
- Contracts deep dive
- Current org design
- Current tech landscape
- Current biz processes



842 Impact Assessment

- Key impacts of ASC 842
- Critical gaps
- External auditor findings



Operational & Technology Strategy

- Define requirements
- Evaluate vendors
- Select vendor
- Define implementation scope, timeline and budget

Implementation Management



Business Process & System Design

- Detailed system design
- Templates and tools
- Stakeholder impact (tax, treasury)



Lease Abstraction & System Config

- Configure software
- Abstract leasing data
- Feedback from external auditors



System Testing and Validation

- Testing plan
- Execution of test plan
- Validation of lease calculations
- Issue tracking

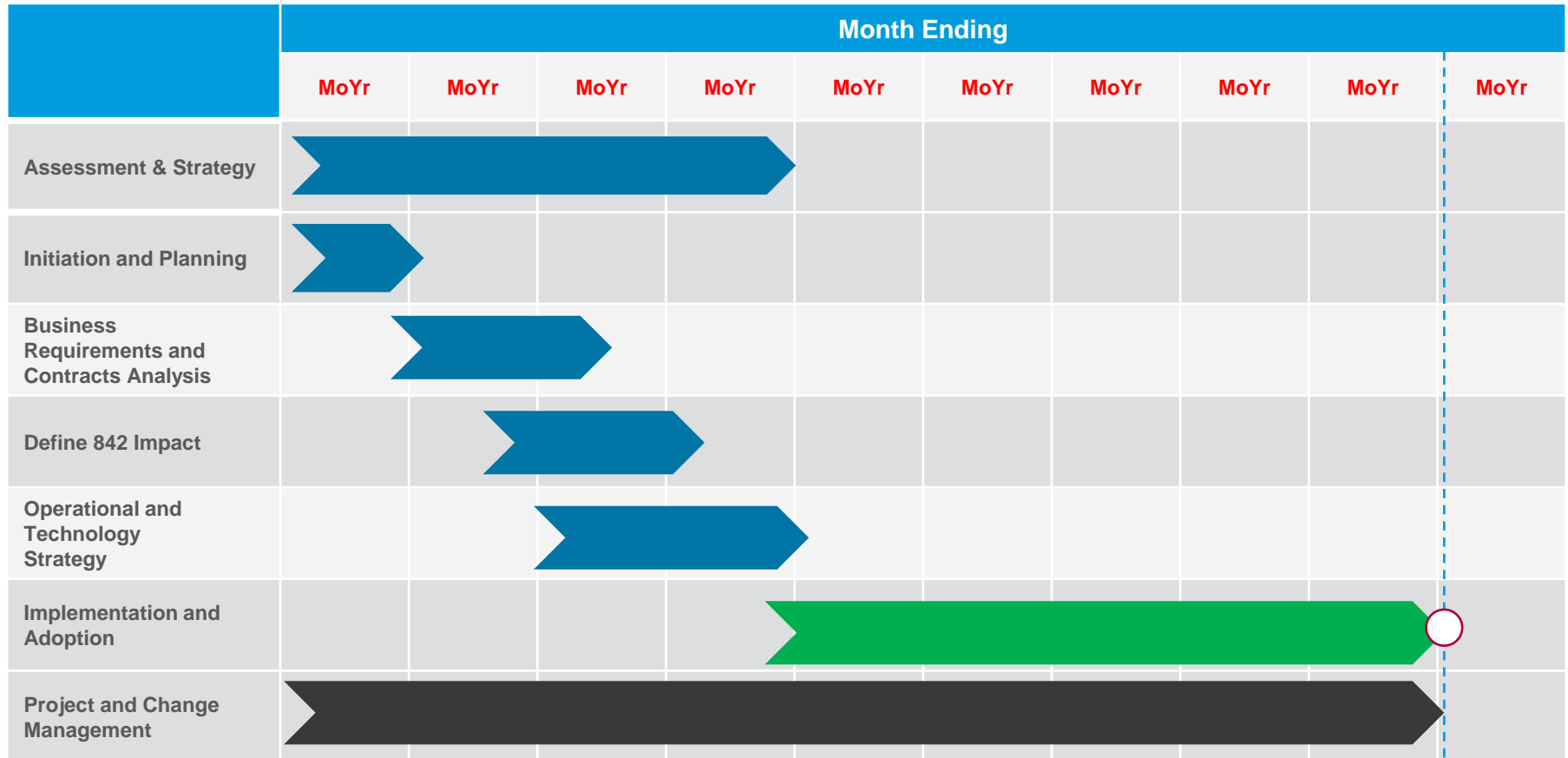


Deployment, Training and User Adoption

- Training for accounting users (optional)
- Training for procurement users (optional)
- Internal controls (optional)

Project Management, Communication and Change Enablement

Integrated implementation timeline - SAMPLE



- ▶ Assessment & Strategy Phase
- ▶ Implementation and Adoption Phase

○ Go-Live and Adoption

Estimated Resource requirements by phase

Estimated level of resource effort	
Technical Accounting Phases	<client name> requirements
Initiation and Planning	Low
Business Requirements and Contracts Analysis	Medium
Define 842 Impact	Low
Develop Technology and Implementation Strategy	Medium
Implement 842	High

Level of effort estimate (% of time)	
Low	0-15%
Medium	15%-30%
High	>30%

Polling Question #3

What are you planning to do from a technology perspective?

- a) Utilize an excel workbook
- b) Purchase a lease accounting system
- c) Outsource lease accounting
- d) Unsure at this time

LEASE ACCOUNTING SOFTWARE

Enterprise Lease Accounting



Lease Classification

For operating and finance leases with ability to configure policy thresholds and make overrides



Lease Accounting Engine

Asset-level lease accounting sub-ledger that can generate debits and credits for export to the GL



Financial Disclosures

For IFRS and US GAAP. Support for the new lease accounting standards and the current standards



Management Accounting

Reconciliation and roll forward reporting; portfolio and schedule level trial balance reporting

Enterprise Lease Accounting

DEFINING SUCCESS

PASSING FINANCIAL AUDIT



System: Functional and complete reporting developed for over 8 years

Internal Controls for Financial Reporting

PROCESS TRANSFORMATION



Decentralized leasing program becomes part of monthly close

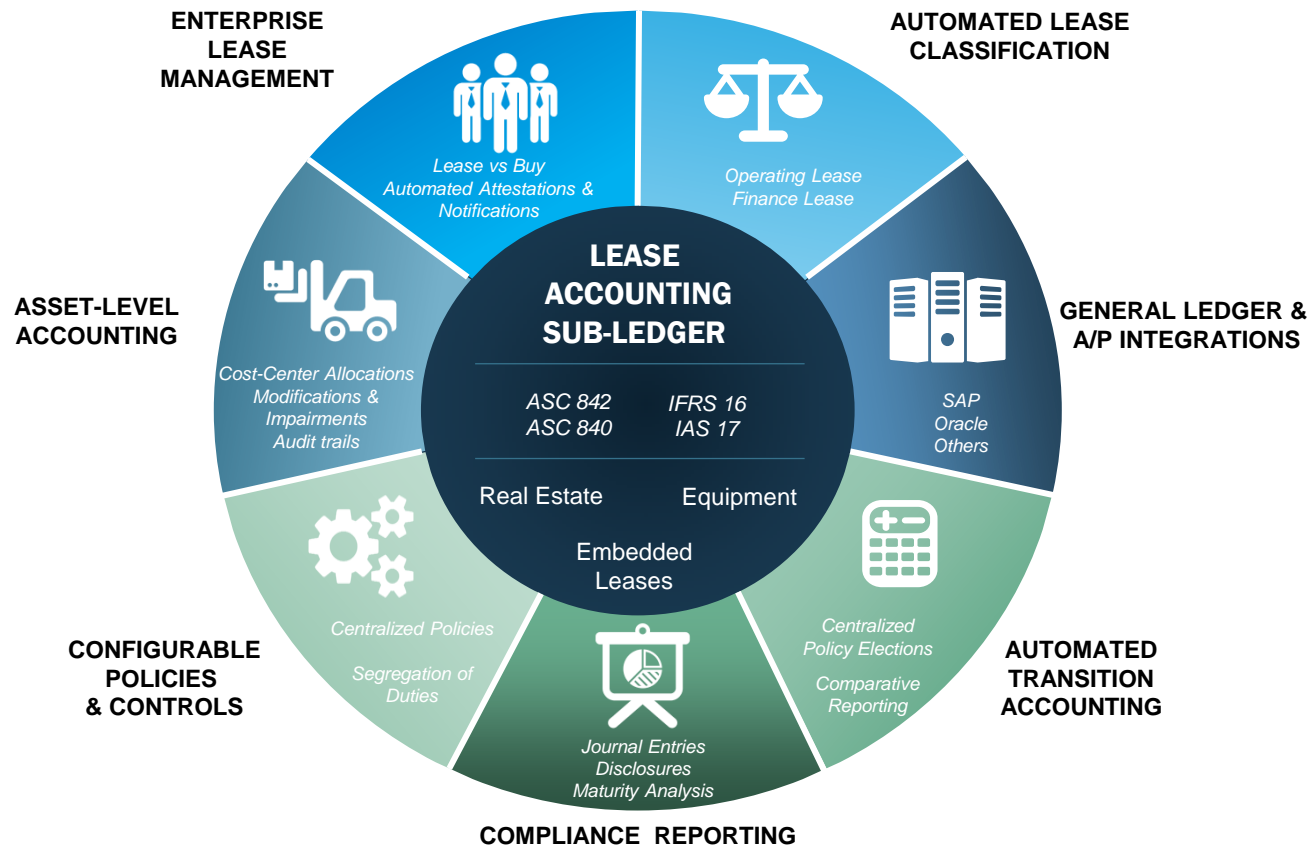
System provides visibility and automation

COST SAVINGS

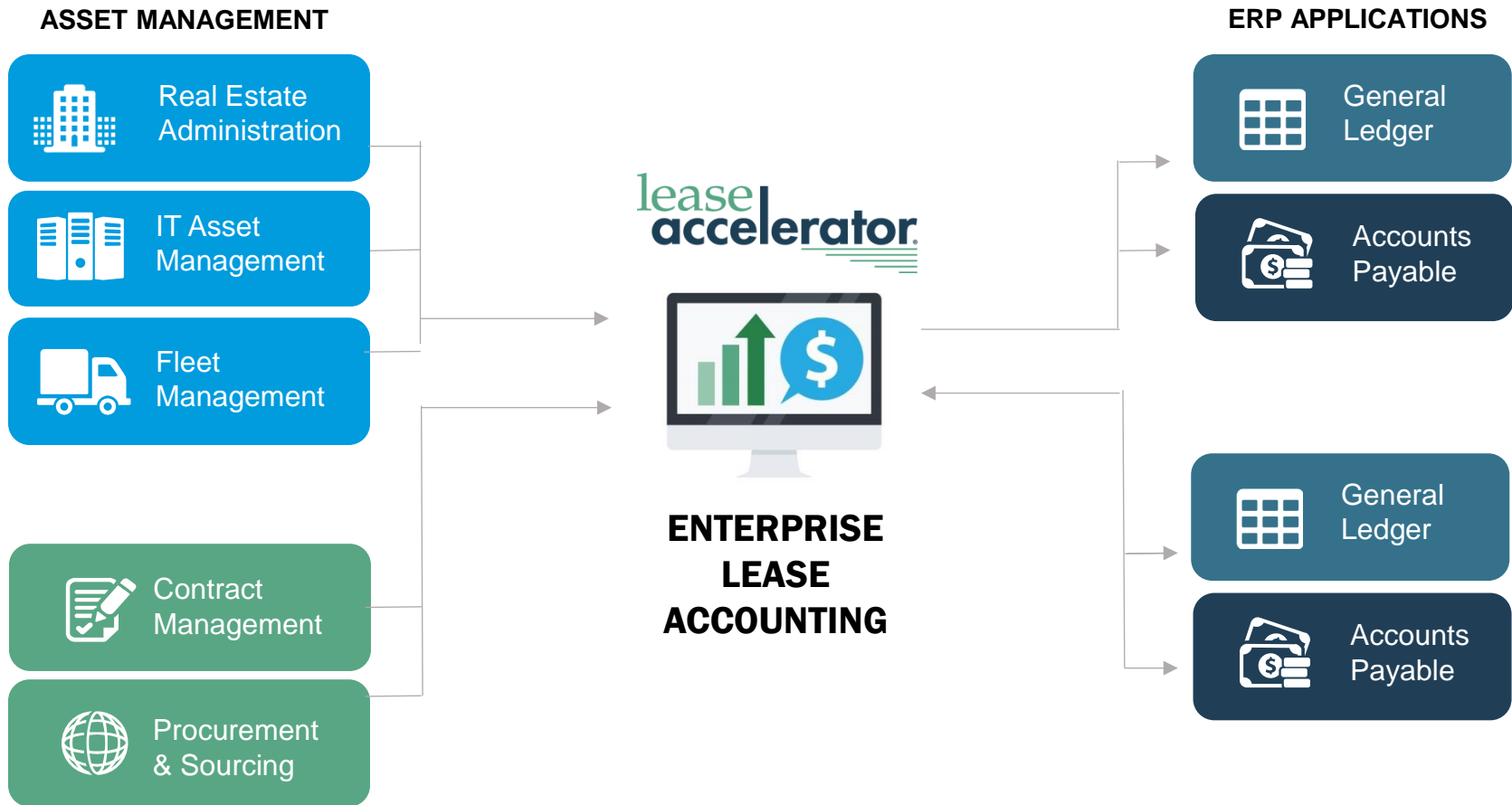


Competitive capital sourcing for equipment

Effective end-of-term management



Most Companies Will Need a Subledger



Decisions and Events Across Lifecycle



Accounting Classification Analysis

ASC 840

Current Standard
US GAAP

Classification Criteria

Short Term Lease
Non-Cancellable
90% of Lease Payments
75% of Economic Life
Ownership Transfer
Bargain Purchase

IAS 17

Current Standard
International

Classification Criteria

Short Term Lease
Non-Cancellable
PV of Lease Payments
Economic Life
Ownership Transfer
Bargain Purchase
Specialized Assets

ASC 842

New Standard
US GAAP

Classification Criteria

Short Term Lease
Non-Cancellable
PV of Lease Payments
Economic Life
Ownership Transfer
Likely Purchase
Specialized Assets

IFRS 16

New Standard
International

Classification Criteria

Short Term Lease
Non-Cancellable
Ownership Transfer
Interrelated Assets
Small Value

Automatically generates recommended classification with option to override

Responsibility Center Accounting

Cost Centers



Entities



Locations



Departments



Projects



Business Units



Assign expenses from leased assets to different responsibility centers



**ENTERPRISE LEASE
ACCOUNTING SOFTWARE**

Enables reporting and analysis at multiple levels within the organization

Real Estate



Data Center



Vehicle Fleet



Office Equipment



Corporate Aircraft



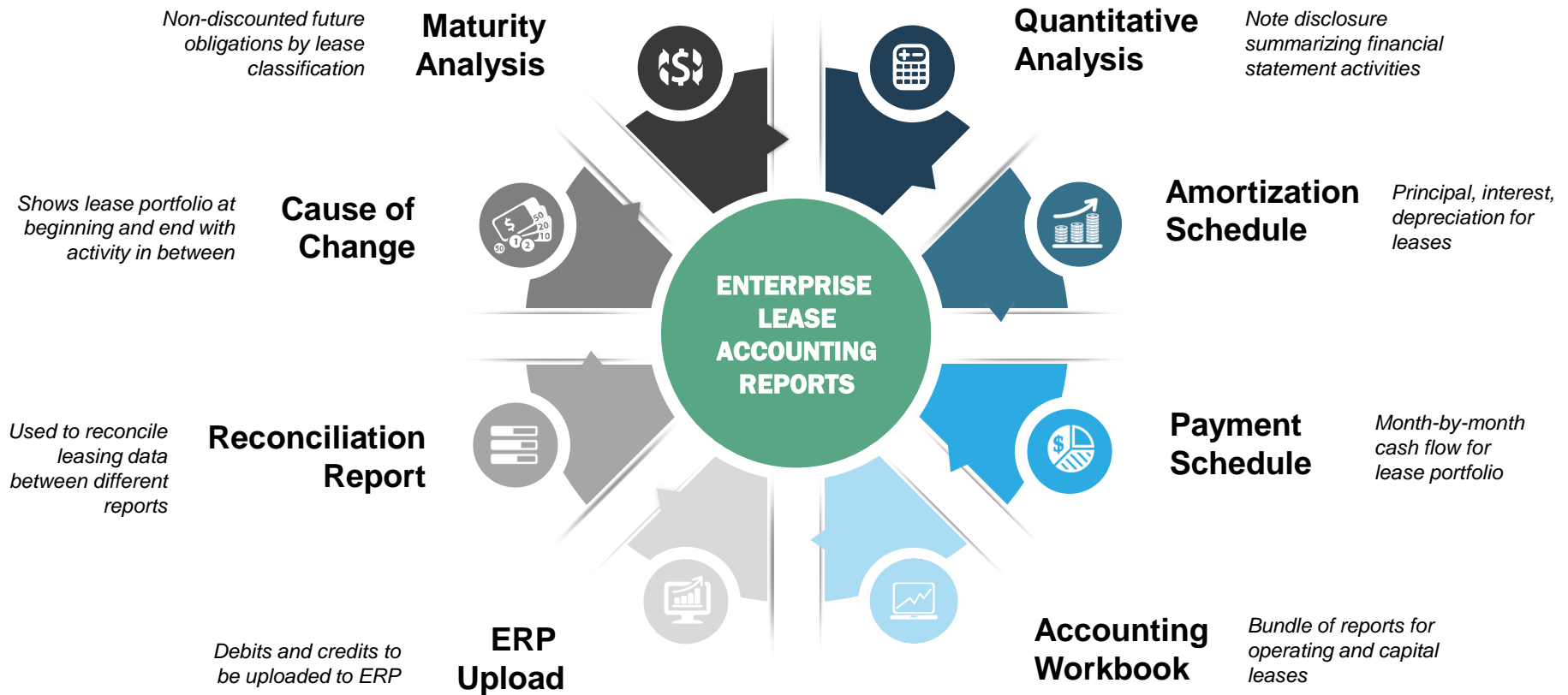
Material Handling



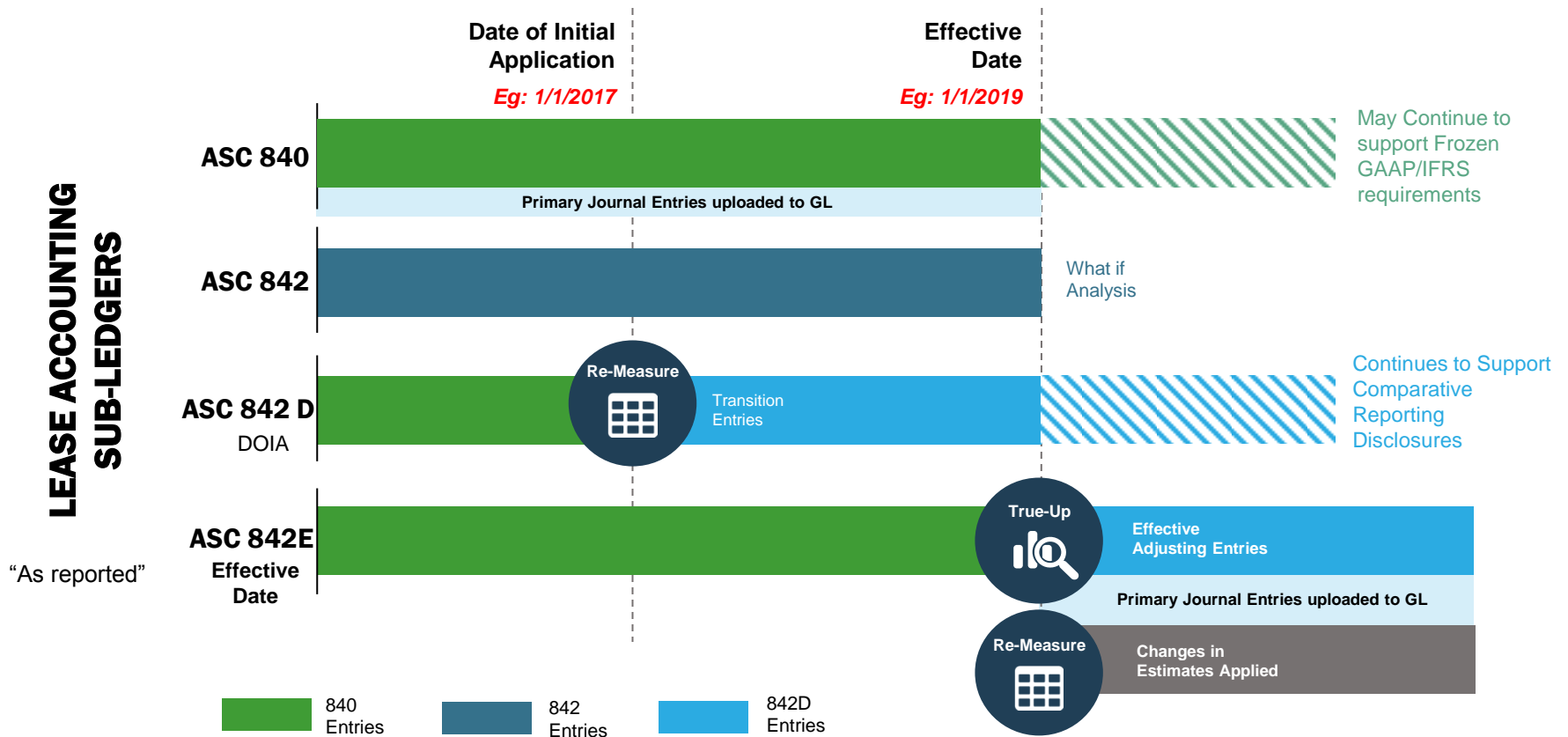
Transportation



Accounting Reports



Transition Accounting – US GAAP



Audit Support

Reconciliation Reporting

*Compares Reports for Tie-Out
Asset details
Ordered items
Payment schedule
Leasing summary*

“As At” Reporting

*Visibility for a Certain Date
Balance Sheet Liabilities
Lease Portfolio*

Asset Change Report

*Between Two Periods
New Leases
Leases Terminated or Purchased
Rent and Foreign Exchange Changes*



Deal History

*Who did what and when?
Classification Changes
Invoice Payments
Accounting Judgments
End User Attestations*

Document Repository

*All Supporting Documents
Master Lease Agreements
Purchase Orders
Lease Classification Analysis*

Asset Level Tracking

*Data tracked for each Asset on Lease
Economic Life
Residual Value
Lease Rate Factor*

Three Golden Requirements

For an Enterprise Lease Accounting Solution

1 Lease Policy Management

Financial controls and flexible workflow to enable the management of lease and accounting policy and ensure SOX and FASB compliance.

- Lease vs. Buy
- Lease Accounting Classification

- ✓ Valuation or Allocation
- ✓ Rights & Obligations
- ✓ Authorization
- ✓ Existence or Occurrence
- ✓ Completeness & Accuracy

2 Equipment Lease Data Management

Manage and track all changes to the leased asset as those changes occur to insure an accurate “system of record” for accounting compliance.

- Mid-Term changes
- End-of-Term changes

- ✓ Completeness & Accuracy
- ✓ Existence or Occurrence
- ✓ Authorization

3 Lease Accounting

Perform accounting calculations and journal entries at the asset level. Manage the accounting for individual business needs to ensure complete and accurate accounting

- Financial Accounting
- Management Accounting

- ✓ Valuation or Allocation
- ✓ Presentation & Disclosure

SOX Requires a “Controlled Environment”

Sourcing



Lessor Community



Data Abstraction



Mid-Term Events



Stakeholder Scorecards



Asset-Level Accounting



Lease versus Buy Analysis



Analyze Proposal Bids



Asset Management



Leasing Portfolio KPIs



Reconciliation Reporting



Request for Proposal



Award Winner



Book Transaction



End-of-Term Notifications



Roll Forward Reporting



Standard Contract



Data Validation



System Reconciliations



Monthly Close



Comparative Reporting

QUESTIONS

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